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THE ATTORNEY-CLIENT RELATIONSHIP AND
THE CODE OF PROFESSIONAL RESPONSIBILITY:
SUGGESTED ATTORNEY LIABILITY FOR
BREACH OF DUTY TO DISCLOSE FRAUD TO
THE SECURITIES AND EXCHANGE COMMISSION

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The imposition of increased obligations and liabilities on securities
lawyers threatens not only the attorney, but the quality of his representation
as well. Alan Myers examines the possible consequences of the current
expansion of liability, and suggests what the securities lawyer's obligations
and liabilities should be under DR 7-102(B)(1) and DR +101(C)(3) of the
Code of Professional Responsibility.

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I. PREFACE: THE EMERGING RESPONSIBILITIES OF THE SECURITIES LAWYER

UNTIL quite recently, judicial decisions finding attorneys liable under the federal securities laws did not involve attorneys acting as attorneys, but instead involved attorneys participating directly in "blatantly fraudulent securities schemes." A lawyer's performance did not give rise to a cause of action for injunctive relief, and only his client was liable in damages to the investing public. Similarly, SEC actions against attorneys were reserved for principals in palpably fraudulent schemes.

This traditional reluctance of the SEC to take action against attorneys was at least partially attributable to an implicit belief that an attorney owed primary allegiance to his client. In *American Finance Co.*, the SEC articulated this traditional view of the attorney's role by stating:

Though owing a public responsibility, an attorney in acting as the client's advisor, defender, advocate and confidant enters into a personal relationship in which his principal concern is with the interests and rights of his client.

We live, however, in an age "where [the] consumer is king." Sanctions and liabilities under the securities laws are no longer reserved for the attorney who is an active participant or prime mover in an obviously deceptive scheme.

Although the nature and extent of the securities lawyer's new responsibilities to the investing public, and the civil damages that will


3. Lowenfels, supra note 2, at 413-15.

4. Id. at 413-14.

5. Id. at 415.


7. Id. at 1049, quoted in Lowenfels, supra note 2, at 415-16, and Schneider, Securities Lawyers' Professional Responsibility, in SEC '75, at 3, 5 (Law Journal Press 1975). The ABA Committee on Professional Responsibility formerly expressed a similar view. As recently as 1965 it suggested that, aside from the absolute prohibition against intentionally aiding fraud, the lawyer's duty to a public agency was secondary to his duty to his client. See ABA Comm. on Professional Ethics, Opinions, No. 314 (1965).

8. Emerging Responsibilities, supra note 1, at 83,693.

surely flow therefrom,\textsuperscript{10} are still "in an embryonic stage of development and their boundaries are by no means fixed or immutable,"\textsuperscript{11} recent SEC releases, staff speeches\textsuperscript{12} and increasingly frequent suits against lawyers and law firms,\textsuperscript{13} have signaled a departure from the SEC position in \textit{American Finance} and an intention to require securities lawyers "to redefine their roles, and to assume more of an enforcement and protection-of-the-public-interest approach to their practices."\textsuperscript{14} Such an approach, premised on the SEC's contention that the securities lawyer's primary duty is to the investing public, not to his client, and that he has an obligation to report his client's securities

\begin{enumerate}
\item Since the \textit{National Student Marketing Complaint} a spate of private class actions have been filed against attorneys, espousing and extending the new theory expressed in \textit{that} complaint." Bauman, \textit{A Comment on the Perils of a Securities Lawyer}, 3 Sec. Reg. L.J. 291 (1975); accord, ABA Section of Litigation, Lawyers and Accountants on Trial: Professional Liability 77 (1975) (remarks of Richard Murray, General Counsel of Touche, Ross & Co.); see \textit{Wall St. J.}, Feb. 3, 1976, at 1, col. 1 (surge in attorney malpractice actions).
violations to the Commission,\textsuperscript{15} may necessitate more detailed, candid disclosures to the SEC.

Needless to say, the SEC's new posture has not lacked critics. The most strenuous criticism has come from those who assert that the SEC's position, threatening dilution of the traditional privilege of a client to consult with his attorney in the fullest confidence without fear of possible disclosure at some indefinite point in the future, is certain to undermine the attorney-client relationship.\textsuperscript{16} The amount and kind of information revealed to corporate counsel may be affected as corporate clients learn that it could be imprudent to reveal too much to an attorney who may owe his primary duty to the SEC.\textsuperscript{17} In fact, some practitioners are concerned that in this particular area of the law, if the client is not secure in his belief that the attorney-client privilege will be respected, it is a virtual certainty that he will thereafter be less than candid with his attorney. One commentator has said:

[T]he savvy client, the knowledgeable client, will not talk to the corporation's lawyer; he will have his conversations elsewhere. As a result, society will be deprived of the vital opportunity for corporate lawyers in the hard cases to stop violations before they occur.\textsuperscript{18}

The current trend has also led to an increase in the cost of, or even

\textsuperscript{15} Lowenfels, supra note 2, at 418-19; Emerging Responsibilities, supra note 1, at 83,689: "We are consistently reminded that historically the attorney has been an advocate, that his professional ethics have over the years defined his function in those terms, that such a role includes unremitting loyalty to the interests of his client . . . . I would suggest that in securities matters . . . the attorney will have to function in a manner more akin to that of the auditor than to that of the advocate"; Finkelstein, Who is the Client? Attorney's Role in Securities Law, 171 N.Y.L.J., June 12, 1974, at 1, col. 3.


\textsuperscript{17} Lowenfels, supra note 2, at 435.

\textsuperscript{18} See Leiman, Responsibility to Report Securities Law Violations, in PLI Sixth Annual Institute on Securities Regulation 276 (R. Mundheim, A. Fleischer, J. Schupper, J. Jewett & J. Thomson eds. 1975) (comments of Mr. Wheat) [hereinafter cited as Leiman]. No studies confirming or contradicting the feared decrease in client candor have been uncovered. See also pt. V infra.
inability to obtain, malpractice coverage, and this is certain to affect the availability of quality securities representation. Rather than weeding out the careless, the competent may be deterred, particularly from representing marginal companies. If marginal companies are able to secure competent representation, the cost of the representation will undoubtedly reflect the lawyer's costs as a near guarantor of his legal services. But in addition to the probable increased cost of and decreased availability of quality legal services, to the extent that counsel risks personal liability in handling complex, litigation-prone matters, his interest in self-protection may actually conflict with the interests of his corporate client; he may decide that it is safer to protect the investing public than to effectively represent his client—the corporation and its existing shareholder.

These problems have been brought to a head, and the debate has become all the more impassioned, since the SEC's filing of its now celebrated National Student Marketing complaint. After briefly examining that complaint, with special emphasis upon the SEC's conception of an attorney's duty to disclose fraud to it, this Article will discuss the extent to which there should be a duty to disclose securities fraud, and the consequences of such a breach. The discussion of an attorney's duty will involve an examination of the attorney-client privilege and the ABA Code of Professional Responsibility. The discussion of the consequences of a breach of duty will entail an examination of the recent development of aiding and abetting liability, and a treatment of SEC Rule of Practice 2(e).

II. National Student Marketing: An Introduction to the Attorney-Client Relationship and the Duty to Disclose Fraud to the Securities and Exchange Commission

On February 3, 1972, the SEC charged National Student Marketing Corporation and its accountants, Peat, Marwick, & Mitchell Com-

21. Leiman, supra note 18, at 288; see Schneider, supra note 7, at 9.
pany, with extensive violations of the antifraud provisions of the federal securities laws. It also joined as defendants two of the nation's most prestigious law firms, White & Case of New York, and Lord, Bissell & Brook of Chicago. "Of greater significance than the filing of the complaint itself was the Commission's claim that the law firms had an obligation of allegiance to the Commission greater than the obligation to their own clients."26

The National Student Marketing allegations have been discussed at length elsewhere27 and need not be repeated here in full. For purposes of analyzing the SEC's conception of the duties of the securities attorney, it is sufficient to note that White & Case, and Lord, Bissell & Brook, counsel for the two parties, allowed a merger between National Student Marketing and Interstate National Corporation to take place without informing shareholders of material facts first disclosed after the proxy solicitation approving the merger. In reliance upon a provision in the merger agreement permitting the board of directors of each corporation to waive shareholder approval of the disclosures,28 the two law firms issued opinion letters stating inter alia that "all . . . actions and proceedings required by law or this agreement . . . have been duly and validly taken."29

Paragraph 48(i) of the Commission's National Student Marketing complaint explains how the SEC believes these firms failed to fulfill their responsibility to the investing public:

As part of the fraudulent scheme [counsel] failed to refuse to issue their opinions . . . and failed to insist that the financial statements be revised and shareholders be resolicited, and failing that, to cease representing their respective clients and, under the circumstances, notify the plaintiff Commission concerning the misleading nature of the nine month financial statements.30

The SEC's position that counsel should have withdrawn and disclosed the "fraud" is unprecedented.31 This position at least impliedly

27. See Golberg, Introduction to Expanding Responsibilities Under the Securities Laws at xiii-xvii (S. Goldberg ed. 1973) [hereinafter cited as Expanding Responsibilities].
28. See Ethical Dilemma, supra note 26, at 300-01.
29. Id. at 301-02.
30. National Student Marketing Complaint ¶ 48(i), supra note 22, at 91,913-17 (emphasis added).
31. Note that if White & Case was justified in relying upon the waiver provision then there was no fraud to disclose, while if they were not justified in relying upon the waiver then they should have refused to issue the opinion letter, in which case there would have been no closing and, again, no fraud to disclose. Thus, it has been said that the National Student Marketing complaint "confuses two distinct issues—the legality of giving the opinion and a lawyer's duty to notify the SEC of a client's planned violation." Shipman, The Need for SEC Rules to Govern the
suggests that the SEC is seeking to define an attorney's duties to his client, to the public and to the Commission in light of the Code of Professional Responsibility, and that the SEC believes that the Code requires disclosure. The question remains whether this SEC position represents a good policy in light of the purposes of the attorney-client privilege and the objectives of the securities laws.

III. THE ATTORNEY-CLIENT PRIVILEGE

A. In General

The attorney-client privilege is important to an understanding of the nature of the lawyer-client relationship and the social interest in


32. A reading of ABA Code of Professional Responsibility DR 7-102(B)(1) (1975) suggests, at least to this author, that paragraph 48(i) of the National Student Marketing complaint was drafted in direct reliance on this disciplinary rule. See text accompanying note 82 infra for the text of DR 7-102(B)(1). But despite the SEC's apparent reliance on the Code in this instance, on other occasions members of the SEC have contended that a securities lawyer's duties may surpass those of the ordinary attorney who is bound by the Code. See, e.g., Emanuel Fields, SEC Securities Act Release No. 5404 (June 18, 1973), [1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 79,407, at 83,175 n.20. See also Emerging Responsibilities, supra note 1, at 83,689-90; text accompanying notes 179-80 infra; note 160 infra. On the issue of the Code and the National Student Marketing complaint compare Koch, Attorneys' Liability: The Securities Bar and the Impact of National Student Marketing, 14 Win. & Mary L. Rev. 883 (1973) (the attorney-client relationship must give way to the protection of investors under the facts of National Student Marketing), with Karmel, Attorneys' Securities Laws Liabilities, 27 Bus. Law. 1153, 1162-64 (1972) (an attorney's duty to disclose fraud to the SEC or to the public investor could prove inimical to existing attorney-client relationships).

33. The Federal Rules of Evidence, which took effect on July 1, 1975, do not contain a specific attorney-client privilege, although an earlier draft of the rules, see 56 F.R.D. 183, 235-37, did contain a detailed attorney-client privilege. Rule 501, the general federal rule with respect to privileges, provides in pertinent part: "[T]he privilege of a witness . . . shall be governed by the principles of the common law as they may be interpreted by the courts of the United States in the light of reason and experience. However, in civil actions and proceedings, with respect to an element of a claim or defense as to which State law supplies the rule of decision, the privilege of a witness . . . shall be determined in accordance with State law." Rule 501 appears to suggest that federal common law will govern the applicability of the attorney-client privilege in federal securities cases. See also Kaminsky, State Evidentiary Privileges in Federal Civil Litigation, 43 Fordham L. Rev. 923 (1975).

34. Any testimonial privilege is an exception to the general duty of every person to testify as to all facts inquired of in a court of law. The hornbook rule on the attorney-client privilege is that "(1) Where legal advice of any kind is sought (2) from a professional legal advisor in his capacity as such, (3) the communications relating to that purpose, (4) made in confidence (5) by the client, (6) are at his instance permanently protected (7) from disclosure by himself or by the legal adviser, (8) except if the protection be waived." 8 J. Wigmore, Evidence § 2292 (McNaughton rev. ed. 1961). In United States v. United Shoe Mach. Corp., 89 F. Supp. 357 (D. Mass. 1950), Judge
fostering that relationship. Accordingly, it is also important to an understanding of the policy considerations underlying the proper resolution of the problems raised by National Student Marketing.35

The attorney-client privilege exists to promote optimal advocacy by encouraging clients to communicate all relevant facts to counsel36 “without fear of consequences or the apprehension of disclosure.”37 “The protection is not [limited] to proceedings pending or in contemplation, nor is it material that the client [is not] before the court where disclosure is sought . . . .”38

Wigmore suggests four criteria for determining when a privilege should exist. Of these criteria, the fourth is most pertinent to this Article’s analysis:

(4) The injury that would inure to the relation by the disclosure of the communications must be greater than the benefit thereby gained for the correct disposal of the litigation.39

B. Ongoing and Future Crime-Fraud Exception to the Attorney-Client Privilege 40

A client’s communications with his attorney regarding past, completed crimes or frauds are privileged and cannot be divulged without

Wyzanski formulated the classic rule that “[t]he privilege applies only if (1) the asserted holder of the privilege is or sought to become a client; (2) the person to whom the communication was made (a) is a member of the bar of a court, or his subordinate and (b) in connection with this communication is acting as a lawyer; (3) the communication relates to a fact of which the attorney was informed (a) by his client (b) without the presence of strangers (c) for the purpose of securing primarily either (i) an opinion on law or (ii) legal services or (iii) assistance in some legal proceeding, and not (d) for the purpose of committing a crime or tort; and (4) the privilege has been (a) claimed and (b) not waived by the client.” Id. at 358-59. See also N.Y. C.P.L.R. § 4503(a) (McKinney 1963).

35. See Borden, Privilege and the Attorney-Client Relationship, in Expanding Responsibilities, supra note 27, at 36.


37. Modern Woodmen of America v. Watkins, 132 F.2d 352, 354 (5th Cir. 1942); accord, United States v. Louisville & N.R.R., 236 U.S. 318, 336 (1915); W. Richardson, Evidence § 410 (10th ed. 1973); C. McCormick, Evidence § 98 (2d ed. 1972); J. Weinstein & M. Berger, Evidence ¶ 503[02] (1975); 8 Wigmore, supra note 34, ¶ 2291. See also ABA Code of Professional Responsibility EC 4-1 (1975) (“A client must feel free to discuss whatever he wishes with his lawyer and a lawyer must be equally free to obtain information beyond that volunteered by his client.”)


39. 8 Wigmore, supra note 34, ¶ 2285, at 527 (emphasis deleted). The first three criteria are: “(1) The communications must originate in a confidence that they will not be disclosed. (2) This element of confidentiality must be essential to the full and satisfactory maintenance of the relation between the parties. (3) The relation must be one which in the opinion of the community ought to be sedulously fostered.” Id. (emphasis deleted).

40. For comparison of this exception to the attorney-client privilege and an attorney’s affirmative
the client's consent. However, with respect to ongoing and future crimes or frauds the general rule is that communications made by a client to his attorney are not privileged, irrespective of whether the attorney knows about or is involved in the fraud or crime.

C. Prima Facie Proof of Fraud

The attorney-client privilege may not be pierced by a mere allegation of crime of fraud; otherwise an attorney's testimony could be compelled by baseless allegations, and the crime-fraud exception would emasculate the attorney-client privilege. Rather, what is required is some colorable charge of fraud; that is, there must be "prima facie evidence that . . . has some foundation in fact."

The rationale for a prima facie showing appears to be a policy of defining exceptions to the attorney-client privilege as narrowly as possible so as not to impede freedom of consultation between clients and their lawyers. As will be discussed later in this Article, this consideration should also mandate a heavy burden of proof to overcome the attorney-client privilege in securities matters.
D. Applicability of the Attorney-Client Privilege to SEC Proceedings

*McMann v. SEC*[^47^] involved an application to enjoin the plaintiff's stockbroker from complying with an SEC order to turn over to the Commission for use in an SEC investigation papers and documents relating to the plaintiff's account. The court said that SEC investigations are "subject to the same testimonial privileges as judicial proceedings,"[^148^] including the attorney-client privilege.^[49^]

E. The Corporate Attorney-Client Privilege—Will It Survive?

Under federal law, the attorney-client privilege applies to corporations.^[50^] The leading case is *Radiant Burners, Inc. v. American Gas Association.*[^51^] There the court reviewed the law relating to and the policies underlying the privilege (i.e., to encourage clients to seek legal advice and to communicate candidly with counsel),[^52^] and concluded that corporations may avail themselves of the privilege in the same manner and to the same extent as non-corporate clients.^[53^] This principle has been repeatedly reaffirmed.^[54^]

In *Garner v. Wolfinbarger,*[^55^] a recent common law and securities fraud action in which stockholders sued their corporation and its officers to recover the purchase price of their stock, the Fifth Circuit Court of Appeals affirmed the continued existence of an attorney-client privilege for the corporate client.

The corporation is not barred from asserting [the attorney-client privilege] merely because those demanding information enjoy the status of stockholders.^[56^]

[^47^]: 87 F.2d 377 (2d Cir.), cert. denied, 301 U.S. 684 (1937).
[^48^]: Id. at 378.
[^49^]: See Annot., 133 A.L.R. 732 (1941).
[^51^]: 320 F.2d 314 (7th Cir. 1963).
[^52^]: Id. at 322, 324; see 8 Wigmore, supra note 34, § 2291.
[^56^]: Id. at 1103.
However, the court held that the corporate attorney-client privilege is not absolute where it is asserted against those to whom the corporation owes a fiduciary duty.\textsuperscript{57}

Where the corporation is in suit against its stockholders on charges of acting inimically to stockholder interests, protection of those interests as well as those of the corporation and of the public require that the availability of the privilege be subject to the right of the stockholders to show cause why it should not be invoked in the particular instance.\textsuperscript{58}

But while the special nature of the corporate-stockholder relationship led the court in \textit{Garner} to reevaluate the balance of interests that traditionally has determined the availability of the privilege and caused it to hold that the attorney-client privilege is qualified in stockholder derivative suits, the decision clearly did not limit the privilege as against other adversaries to whom no similar fiduciary obligation is owed.

The principles underlying \textit{Garner} were extended by the recent case of \textit{Valente v. PepsiCo, Inc.}\textsuperscript{59} PepsiCo bought seventy-four percent of the outstanding stock of Wilson and consummated a short form merger under the applicable Delaware Corporation Law. When Wilson’s minority shareholders then sued PepsiCo for damages, PepsiCo claimed the attorney-client privilege as to a number of documents relating to the reasons for PepsiCo’s decision to use that particular take-over device. The court rejected the assertion of the privilege, relying on a purported rationale of \textit{Garner} to the effect that the societal interest in preserving fiduciary duties outweighs the societal interest underlying the attorney-client privilege.\textsuperscript{60}

The court first disallowed the privilege with respect to opinions issued to PepsiCo by attorneys who were directors of Wilson while representing PepsiCo in relation to the proposed take-over of Wilson. Since the attorneys owed conflicting fiduciary duties to PepsiCo and Wilson, the court held that, as in \textit{Garner}, the privilege could not be

\textsuperscript{57} The court emphasized that the fiduciary obligation of corporate management to its stockholders was the basis of its holdings: “We consider [the balancing of injury from disclosure against the benefit from correct disposition of the case] in a particularized context: where the client asserting the privilege is an entity which in the performance of its functions acts wholly or partly in the interests of others, and those others, or some of them, seek access to the subject matter of the communications.” \textit{Id.} at 1101.

\textsuperscript{58} \textit{Id.} at 1103-04. The court referred to 8 Wigmore, supra note 34, \textsection 2285(4) (quoted at text accompanying note 39 supra), and concluded that the benefit from disclosure would outweigh the injury that might result. \textit{Id.} at 1100-02.

\textsuperscript{59} 68 F.R.D. 361 (D. Del. 1975).

\textsuperscript{60} \textit{Id.} at 368.
used to shield the fiduciary from the shareholder-principal to whom he must account.\textsuperscript{61} It should be noted, however, that in \textit{Garner} the shareholder-principal was the corporation's own shareholders, whereas in \textit{Valente} the shareholder-principal was Wilson's shareholders, who were permitted to pierce PepsiCo's corporate attorney-client privilege. Moreover, \textit{Garner} had explicitly refused to hold that the corporate-shareholder fiduciary relationship itself outweighed the policies advanced by the attorney-client privilege.\textsuperscript{62} Whereas \textit{Garner} held that shareholders have a burden of showing good cause to overcome the privilege,\textsuperscript{63} \textit{Valente} shifted the burden of proof to the corporation to show cause to sustain the privilege.

Where a corporation seeks advice from legal counsel, and the information relates to the subject of a later suit by a minority shareholder in the corporation, \textit{the corporation is not entitled to claim the privilege as against its own shareholder, absent some special cause.}\textsuperscript{64}

Second, the court disallowed the privilege as to four other documents on the ground that the client, PepsiCo, as the controlling shareholder of Wilson, owed fiduciary duties to Wilson and that to subordinate these duties to the attorney-client privilege would be a fraud.

Where the fiduciary has conflicting interests of its own, to allow the attorney-client privilege to block access to the information and bases of its decisions as to the persons to whom the obligation is owed would allow the perpetration of frauds.\textsuperscript{65}

The court continued in a footnote:

The Court here does not hold that the attorney-client privilege was used in the perpetration of fraud. . . . Rather the decision of the Court is that \textit{where a fiduciary represents conflicting interests, particularly where one of those interests is its own, the only purpose to be served by the use of the privilege to withhold information from those to whom the fiduciary obligation runs is fraud}. The more general and important right of those who look to fiduciaries to safeguard their interests, to be able to determine the proper functioning of the fiduciary, outweighs the need for the privilege . . . .\textsuperscript{66}

In sum, \textit{Valente} extends \textit{Garner} both by permitting shareholders of one corporation to overcome another corporation's attorney-client privilege and by eliminating the requirement that the shareholder show cause to overcome the privilege. After \textit{Valente}, mere assertion of a

\begin{itemize}
\item \textsuperscript{61} Id.
\item \textsuperscript{62} 430 F.2d at 1103-04; see text accompanying note 56 supra.
\item \textsuperscript{63} 430 F.2d at 1104.
\item \textsuperscript{64} 68 F.R.D. at 367 (emphasis added).
\item \textsuperscript{65} Id. at 369.
\item \textsuperscript{66} Id. at 369-70 n.16 (emphasis added).
\end{itemize}
fiduciary relationship would appear sufficient to overcome the privilege. 67

*Garner* and *Valente* raise at least two major problems for corporations and their counsel. The first is whether courts will find additional "particularized contexts" warranting further exceptions to the attorney-client privilege. 68 For example, a court conceivably could find a fiduciary relationship between a publicly-traded corporation and the SEC or the investing public. It is suggested, however, that further exceptions in this area should be made slowly and cautiously lest a corporation inadvertently be denied the right to effective legal counsel.

Second, the spectre of stockholders piercing the attorney-client privilege in future derivative suits will undoubtedly affect the attorney-corporate client relationship. One possible result is that management will be less candid with counsel. 69 Another is that counsel may refrain from putting in writing its opinions as to the legality of a securities transaction, or may become overly cautious in advising on legality 70 for fear of shareholder discovery of the advice and consequent suit—by the shareholders, or by the corporation if the corporation is sued by the shareholders. A final possibility is that corporate management will accept counsel's opinion as to the legality of a particular securities transaction rather than risk shareholder discovery of such unheeded advice. 71

There nevertheless will be instances when a client will choose to disregard its attorney's advice and take action which the attorney clearly believes will violate the federal securities laws. What the attorney's duties and loyalties are and should be in this and similar situations is examined in the following section of this Article.

67. But see the court's disclaimer that "[t]he documents in question here must...be seen in light of the obligations which are part of the circumstances of this case. The Court makes no rule regarding discovery as to corporations in general..." Id. at 368.

68. The Garner court characterized that situation as a "particularized context." 430 F.2d at 1101.

69. See text accompanying notes 17-18 supra.

70. See text accompanying note 21 supra.

71. One commentator contends that: "The suggestion that a lawyer representing a client which plans to disregard the lawyer's advice that a course of action is illegal must withdraw from representation and report the client's plan to the proper authorities is simultaneously the most controversial and the most unimportant of the developments concerning lawyers' duties under the securities acts. The question is relatively unimportant because clients have seldom proceeded in the face of an attorney's advice that to do so is illegal and because in the future the situation will arise even less often. One clear impact of Garner v. Wolfinbarger will be almost total compliance with counsel's injunctions that a planned course of action is illegal or will create liability, for that advice is now subject to discovery by shareholders, and a management proceeding against counsel's advice surely builds a strong case against itself." Shipman, supra note 31, at 276-77 (footnote omitted; italics deleted).
IV. THE CODE OF PROFESSIONAL RESPONSIBILITY: 
THE ATTORNEY-CLIENT RELATIONSHIP AND THE DUTY 
TO DISCLOSE FRAUD TO THE SECURITIES AND EXCHANGE 
COMMISSION

A. A Redefinition of the Securities Lawyer’s Role

“The effective functioning of the federal securities laws contemplates 
the involvement of professionals.” For example, although “there is 
no requirement that disclosure documents filed with the [SEC] be 
reviewed by attorneys, . . . as a practical matter [it would] be difficult 
for a layman to comply with all of the statutory requirements without 
assistance of counsel.” Securities counsel have pursued this review of 
their clients’ disclosure documents with such vigor that this role can 
almost be termed adversarial to the client.

Ironically, these achievements of practicing lawyers in helping to 
promote effective compliance with the securities laws are being used 
today to support the proposition that “for the investment protection 
purposes of the federal securities laws to be fulfilled, the attorney must 
be made to serve two masters—his client and the investing public.” Indeed, the SEC appears to be suggesting that in particular instances a 
securities lawyer's duty to the investing public “might override the 
loyalty to the client and even the lawyer-client privilege” and 
compel him to disclose otherwise confidential information. The SEC 
sets forth this obligation to disclose confidential information in para-
graph 48(i) of the National Student Marketing complaint, which, as 
noted earlier, closely follows the language of DR 7-102(B)(1) of the 
Code of Professional Responsibility. This may imply that the Code, 
particularly DR 7-102(B)(1), is the SEC’s basis for maintaining that 
there are situations in which an attorney is compelled to disclose 
information received from his client in the course of a professional 
relationship.

72. See generally Leiman, supra note 18.
73. Sonde, supra note 12, at 1.
74. Id. at 1-2.
76. Comment, SEC Disciplinary Rules and the Federal Securities Laws: The Regulation, 
Role and Responsibilities of the Attorney, 1972 Duke L.J. 969, 1018 (emphasis in original); see 
Emerging Responsibilities, supra note 1. See generally Cohen, Wheat & Henderson, Professional 
Responsibility—The Corporate Bar, in PLI Fourth Annual Institute on Securities Regulation 
182-83 (R. Mundheim, A. Fleischer & J. Schupper eds. 1973) [hereinafter cited as Cohen, Wheat 
& Henderson].
77. Cohen, Wheat & Henderson, supra note 76, at 183.
78. See note 32 supra and accompanying text.
B. Some Thoughts on the Code of Professional Responsibility

Any examination of an attorney's obligation to disclose or not disclose material misstatements or omissions to the SEC must begin with canon 4—"[a] lawyer should preserve the confidences and secrets of a client."

"Confidence" refers to information protected by the attorney-client privilege under applicable law [while] "secret" refers to other information gained in the professional relationship that the client has requested be held inviolate or the disclosure of which would be embarrassing or would be likely to be detrimental to the client.

At first glance it appears that canon 4 would proscribe an attorney's disclosure of his client's past, present, and future violations of the antifraud provisions of the securities laws. In addition, canon 7, which obligates a lawyer to represent a client "zealously," impliedly calls for nondisclosure. The principles of canons 4 and 7 are weakened, however, by disciplinary rules under these canons.

DR 7-102(B)(1) provides:

(B) A lawyer who receives information clearly establishing that:
   (1) His client has, in the course of the representation, perpetrated a fraud upon a person or tribunal shall promptly call upon his client to rectify the same, and if his client refuses or is unable to do so, he shall reveal the fraud to the affected person or tribunal, except when the information is protected as a privileged communication.

If an individual embezzles money and later consults an attorney and confesses the crime, DR 7-102(B)(1) does not purport to compel disclosure, since this rule is applicable only when the fraud is committed "in

79. The Code consists of: (1) "Canons [which] are statements of axiomatic norms [which] embody the general concepts from which the Ethical Consideration[s] and the Disciplinary Rules are derived;" (2) "Ethical Considerations [which] are aspirational in character and represent the objectives toward which every member of the profession should strive;" and (3) "Disciplinary Rules [which] state the minimum level of conduct below which no lawyer can fall without being subject to disciplinary action." ABA Code of Professional Responsibility, Preliminary Statement (1975).


80. DR 4-101(A). EC 4-4 states: "The attorney-client privilege is more limited than the ethical obligation of a lawyer to guard the confidences and secrets of his client. This ethical precept, unlike the evidentiary privilege, exists without regard to the nature or source of information or the fact that others share the knowledge. . . ."

81. DR 4-101(C), the disciplinary rule limiting the principle of canon 4, is discussed at text accompanying notes 119-20 infra.

82. See also American College of Trial Lawyers, Code of Trial Conduct Rule 23(j) (rev. ed. 1972) (analogous provision); ABA Canons of Professional Ethics No. 41 (analogous provision of pre-1970 canons).
the course of the representation." Here there was clearly no continuing fraud; any violation of the law took place entirely in the past, so, consistent with the attorney-client privilege, DR 7-102(B)(1) does not compel disclosure.83

The meaning of "in the course of the representation" is not entirely clear and will be explored in greater detail.84 For the moment, however, it should be observed that

In the securities business, we are concerned almost invariably with ... prospective transactions, all of which may be held to be frauds, and even crimes, if the required disclosure is not made.85

In other words, whereas past violations of the law normally fall within the attorney-client privilege, in the "securities business" past disclosure violations become the basis of ongoing disclosure violations if not corrected in current and future disclosure documents. Thus, solely because of the securities laws' continuing disclosure process, DR 7-102(B)(1) has raised problems for securities practitioners and their clients by mandating disclosure of past-ongoing, present, and future securities crimes or frauds.86

C. Analysis of DR 7-102(B)(1)87

1. "Clearly Establishing"

DR 7-102(B)(1) mandates an attorney's disclosure of his client's misrepresentation or omission only where the misrepresentation or omission clearly constitutes fraud, i.e., where the misrepresentation or omission is clearly material. While it is certain that an attorney preparing a securities disclosure document must reveal his client's confidences or secrets if he knows that the information is material and therefore is required to be disclosed, problems arise when considering lesser degrees of scienter.88 Thus, where an attorney is in reckless disregard of his client's material misrepresentation or omission, the fraud may have been clearly established by objective standards, and if

83. If disclosure were compelled in this situation, the Code would be in direct conflict with the attorney-client privilege, which protects past crimes or fraud. See pt. III(A) supra.
84. See pt. IV(C)(2) infra.
86. See generally Cohen, Wheat & Henderson, supra note 76; Leiman, supra note 18.
87. See Address by A.A. Sommer, Jr., Two Problems for Lawyers, Corporate Counsel Section, Dallas Bar Ass'n, Nov. 4, 1975.
88. One practitioner has said that clearly establishing "must mean something more than a vague hint, but probably means something less than 'beyond a reasonable doubt.'" Leiman, supra note 15, at 269.
so should have been disclosed, even though it was not subjectively clearly established to the attorney himself. Where, however, the attorney is merely negligent in failing to discover and disclose his client's material misrepresentation or omission, not only is the fraud not subjectively established, but it is much less objectively "clearly established" as well. In view of this objective and subjective uncertainty, the attorney's conduct should be protected. Finally, there are situations where an attorney has legitimate doubts as to the materiality of the misrepresentation or omission and therefore is unable to say with any reasonable certainty that a fraud is "clearly established." In the latter case, at least, the fraud is not objectively "clearly established;" hence, DR 7-102(B)(1) should not apply and the innocent attorney should not be required to disclose the alleged violation to the Commission.

Various ethical considerations under canon 7 support this result. For instance, a lawyer must "represent his client zealously within the bounds of the law," but "[t]he bounds of the law in a given case are often difficult to ascertain." "The advocate may urge any permissible construction of the law favorable to his client," and the adviser "may continue in the representation of his client even though his client has elected to pursue a course of conduct contrary to [his] advice."

89. For various definitions of materiality see, e.g., Affiliated Ute Citizens v. United States, 406 U.S. 128, 153-54 (1972) (a material fact is one that "a reasonable investor might have considered . . . important"); Mills v. Electric Auto-Lite Co., 396 U.S. 375, 384 (1970) (same); Chris-Craft Indus., Inc. v. Piper Aircraft Corp., 480 F.2d 341, 363 (2d Cir.), cert. denied, 414 U.S. 910 (1973) ("whether a prototype reasonable investor would have relied"); SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968) (en banc), cert. denied, 394 U.S. 976 (1969) ("material facts include . . . those facts . . . which may affect the desire of investors to buy, sell, or hold the company's securities"); List v. Fashion Park, Inc., 340 F.2d 457, 462 (2d Cir.), cert. denied, 382 U.S. 811 (1965) ("whether 'a reasonable man would attach importance'"); Felt v. Leasco Data Processing Equip. Corp., 332 F. Supp. 544, 569 (E.D.N.Y. 1971) ("The SEC has defined [materiality] by looking to what a reasonably prudent investor reasonably ought to know before buying a security"); id. at 566 (full disclosure must be judged by what is material to the sophisticated investor, the securities professional, and the less experienced investor); Escott v. BarChris Constr. Corp., 283 F. Supp. 643, 681-82 (S.D.N.Y. 1968) (prudent investor test); Charles A. Howard, 1 S.E.C. 6, 8 (1934) (same); 17 C.F.R. § 230.401(d) (1975) (same).

90. Leonard Leiman, a well-known securities practitioner, has commented: "None of us has any monopoly on the ability to determine what is or what is not material, and legitimate doubts as to materiality of information ought to protect lawyers from an obligation to say that a violation based on non-disclosure of the information clearly exists or, in the context of Disciplinary Rule 7-102(B), that the information clearly establishes that a fraud has been committed. If doubts as to materiality cloud the issue, fraud is not 'clearly' established, and, presumably, no disclosure to authorities concerning the putative violation would be required." Leiman, supra note 18, at 285-86.

92. Id. EC 7-2.
93. Id. EC 7-4 (emphasis added).
94. Id. EC 7-5.
These ethical considerations recognize the lawyer's fundamental and paramount obligation to serve his client faithfully and vigorously, despite any personal or professional feelings to the contrary. Doubts as to materiality should be treated no differently.

Such doubts frequently arise in the complex area of undisclosed contingent liabilities. Consider the two following hypotheticals:

(1) Company $X$ has violated the antitrust laws, and in six months the statute of limitations will run. If the violation is disclosed, suits will be filed which will bankrupt the company. If the violation is not disclosed, it is likely that it will go undetected until the statute of limitations bars recovery.

(2) Company $Y$ has discovered a serious title defect in one of its valuable properties. The statute of limitations will expire in six months, and it is unlikely that anyone will learn of the defect before then unless Company $Y$ discloses it. If the facts are revealed now, the company will lose two-thirds of its net worth.

At least two commentators have suggested that the possibility of discovery may be considered in determining the materiality of the contingency. This appears to be a sensible approach, since a contingent liability is material only if there is a real threat of its actualizing, which in these hypotheticals would result only from disclosure. It is not an attorney's duty to bankrupt his client for the sake of the public investor, the result of disclosure on either of these sets of facts.

2. "In the Course of the Representation"

Where a lawyer is aware that his client intends to file a patently deceptive securities document there is no doubt that if he does nothing...
and remains in the service of his client he will be permitting his client to perpetrate a fraud "in the course of the representation," and would therefore become obligated to "reveal the fraud to the affected person or tribunal." Under the Code of Professional Responsibility, however, there are a number of steps the securities attorney should take prior to turning in his client.

The attorney's first obligation is to inform management of the fraud and request that it be corrected. If management agrees to do so, there will be no problems under either the securities laws or the Code of Professional Responsibility. If, however, management refuses to correct the misstatement or omission and insists upon filing a misleading document with the SEC, the attorney's obligations to the corporate entity may require him to disclose the relevant facts "to [the] entire board of directors, . . . particularly the outside directors." This course of action was authorized in ABA Opinion 202, issued in 1940.102 There, an attorney retained by a corporation learned of questionable activities by its officers and was convinced that the officers would not make a full report to the board of directors. The Committee said the attorney "may and should" make complete disclosure to the board.103

This obligation to disclose to the board of directors is derived from EC 7-8:

A lawyer should exert his best efforts to insure that decisions of his client are made only after the client has been informed of relevant considerations. A lawyer ought to initiate this decision-making process if the client does not do so.104

An understanding of EC 7-8, as applied to this situation where management refuses to correct a misstatement or omission, depends upon an understanding of who is the corporate client. EC 5-18 attempts to address this question by stating:

A lawyer employed or retained by a corporation or similar entity owes his allegiance to the entity and not to a stockholder, director, officer, employee, representative, or other person connected with the entity.105

100. See ABA Code of Professional Responsibility EC 5-18 (1975).
101. Shipman, supra note 31, at 278; see Gonson, supra note 12, at 5.
102. ABA Comm. on Professional Ethics, Opinions, No. 202 (1940).
103. Id.
105. Unfortunately, "[t]he simple statement that a lawyer owes his allegiance to the 'entity' is often inadequate: Management, the board of directors, and shareholders all may have varying and sometimes conflicting interests in the resolution of a particular issue; and each may claim to represent the best interests of the corporation. This might tend to confuse the lawyer's judgment as to the best interests of the 'entity.' The commentators . . . have explored many of the ramifications of the 'Who is your client?' issue in the corporate/securities area, and have generally
If the full board of directors corrects the disclosure document, there are no further difficulties. If, however, the board refuses to take action to correct the misstatement or omission, or disputes the lawyer's judgment that a material misstatement or omission has been made, then, assuming the board is the "entity" for whom the lawyer works, the lawyer must resign. However, if the board is not the client—if further expansion of Garner v. Wolfinbarger and its progeny leads courts in some circumstances to regard the shareholders as the corporate client—then the question becomes whether a lawyer confronted with a board of directors that refuses to correct a misstatement or omission should, under EC 7-8, notify the shareholders of the relevant facts.

Although this course of action may have some theoretical appeal, as a practical matter such disclosure might actually be detrimental to the corporation since it might result in trading on the information rather than in removing the offending directors. Furthermore, the shareholders of a large, publicly-held corporation are just not a decision-making group. Therefore, the lawyer faced with a recalcitrant board of directors should not, and presently does not, have to disclose the fraud to the shareholders; rather, the attorney's obligation is to resign.

In fact, since DR 7-102(B)(1) applies only to frauds committed in the course of the representation, not before or after, the only obligation concluded that the CPR offers insufficient guidance on the subject. The Code of Professional Responsibility and the Responsibility of Lawyers Engaged in Securities Law Practice—A Report by the Committee on Counsel Responsibility and Liability, 30 Bus. Law. 1289, 1293 (1975) [hereinafter cited as Committee on Counsel Responsibility and Liability]; see Sonde, supra note 12, at 9. On the other hand, the fact that the "entity" is the client may give an attorney comfort when he finds himself faced with intransigent management and feels obligated to report possible securities violations to the board of directors.

109. Committee on Counsel Responsibility and Liability, supra note 105, at 1294.
110. The legal and accounting professions have reached an accord on the analogous problem of disclosure of contingent liabilities. The two groups call only for counsel's resignation when the client disregards advice to disclose an important unasserted claim. See ABA, Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information 6, 17 (1976); Wall St. J., Jan. 8, 1976, at 4, col. 2.
111. See Daley & Karmel, Attorneys' Responsibilities: Adversaries at the Bar of the SEC, 24 Emory L.J. 747, 755 n.42 (1975) ("The affirmative duties imposed by the Rule appear to arise
of an attorney confronted by a board of directors which intends to make a future misstatement or omission despite his advice is to resign. He need not reveal his client's confidences or secrets to the SEC or investors, since at the time of his resignation no fraud had been committed. Furthermore, if the corporation later goes forward and files misleading documents, the attorney still need not disclose because the fraud that arguably has been perpetrated did not take place during the course of the representation.

From a policy standpoint and apart from the mandate of DR 7-102(B)(1), resignation should fulfill an attorney's obligations under these facts. While the lawyer's unequivocal belief that a misleading document is about to be filed necessitates his resignation, it may not justify mandatory disclosure; his judgment as to materiality could be wrong, and if it should later be resolved that the information in fact was not material the lawyer will have been forced to breach his client's trust, perhaps to his client's detriment, without any offsetting benefits to the investing public.

These policies do not militate against permissive disclosure, however. For example, suppose that after an attorney resigns his former client's new counsel calls up and says:

"I noticed that you were on this registration statement and that you no longer are. I have been retained. Were there any specific problems that you encountered that you think you ought to signal to me?"

It has been suggested that in this case "to reveal the confidence of the client directly might well be unethical." However, this approach is incorrect. Where the client refuses to correct alleged misstatements or omissions, and plans to proceed with filing despite his attorney's opinion that it will clearly violate the securities laws, it is likely that the filing will constitute a willful violation of the criminal provisions of the securities laws. Even though DR 7-102(B)(1) does not, and for...
policy reasons should not, compel disclosure of an intention to commit a possible future fraud, under DR 4-101(C)(3) it is permissible,\textsuperscript{119} and therefore not unethical, for an attorney to reveal "[t]he intention of his client to commit a crime and the information necessary to prevent the crime."\textsuperscript{120} Therefore, when the client's intended future conduct appears to be criminal, rather than merely fraudulent, the better view is that DR 4-101(C)(3) is available to permit the first attorney to reveal to his successor information necessary to prevent the willful filing of false and misleading disclosure documents. Indeed, under DR 4-101(C)(3), a lawyer should even be protected were he to take the first step and call the new counsel to apprise him of the relevant facts.

There is at least one factual situation where it can be said with certainty that a fraud has been perpetrated by the client "in the course of the representation." This is where an attorney discovers a material misrepresentation or omission in a past public document or report which he helped to prepare.

If a trading market is still being affected by the defective disclosure document, or if investors who bought in reliance upon it still have a right of rescission, the attorney must advise the corporation that failure to correct the document is a continuing crime and fraud. If the corporation does not issue a public correction, DR 7-102(B)(1) requires the attorney to request correction, and failing that, to notify the SEC.\textsuperscript{121}

material fact . . . " 15 U.S.C. § 77x (1970), as amended, 15 U.S.C.A. § 77x (Supp. 1976). Section 32(a) of the Exchange Act provides for the imprisonment for not more than five years or a fine of not more than $10,000, or both, upon conviction of "any person who willfully and knowingly makes, or causes to be made, any statement in any application, report, or document . . . which statement was false or misleading with respect to any material fact . . . ." Id. § 78ff(a) (1970), as amended, 15 U.S.C.A. § 78ff(a) (Supp. 1976).

119. It must be stressed that DR 4-101(C)(3) is optional; the lawyer is not obligated to discuss his former client's affairs, but to do so is not unethical. But see ABA Code of Professional Responsibility DR 4-101(C)(3), annot. 16 (1975): "ABA Opinion 314 (1965) indicates that a lawyer must disclose even the confidences of his clients if 'the facts in the attorney's possession indicate beyond reasonable doubt that a crime will be committed.' " (italics deleted).

120. DR 4-101(C)(3) (emphasis added; footnote omitted). It should be recalled that the attorney-client privilege does not protect ongoing or future crimes or frauds. Since the client's express intention to engage in conduct that appears to be criminal would not be privileged, even apart from DR 4-101(C)(3) the attorney's disclosure would not breach a confidence. See ABA Code of Professional Responsibility DR 4-101(C)(3), annot. 15 (1975): "We held in Opinion 155 that a communication by a client to his attorney in respect to the future commission of an unlawful act or to a continuing wrong is not privileged from disclosure. Public policy forbids that the relation of attorney and client should be used to conceal wrongdoing on the part of the client." (italics deleted). See also Meyerhofer v. Empire Fire & Marine Ins. Co., 497 F.2d 1190 (2d Cir.), cert. denied, 419 U.S. 998 (1974) (construed DR 4-101(C)(4) as allowing an attorney to reveal privileged information when necessary to defend himself in a lawsuit). One writer views Meyerhofer as "an invitation to join counsel as a defendant as a device to open [his] files to plaintiff's counsel." Leiman, supra note 18, at 290.

121. See Hazard, Attorney's Responsibilities and Duties, in Expanding Responsibilities, supra
If, on the other hand, the investing public is no longer being affected by the misleading document, and the right of rescission is no longer available, then there is no ongoing crime or fraud, and so disclosure would be unnecessary. Since disclosure would do little to rectify the effects of the past misstatement or omission, the underlying purposes of DR 4-101(C)(3) and DR 7-102(B)(1) would not be furthered by disclosure and there would be no reason to compel an attorney to violate the confidences and secrets of his client.\footnote{2}

The most difficult situation is where an attorney learns of a material misstatement or omission by the client in a document filed \textit{before the representation began}. Here it can be argued that the attorney should have no obligation to disclose the information to the SEC because the fraud technically was not perpetrated \textit{"in the course of the representation."} In addition, since the attorney did not participate in the dissemination of the disclosure document, it can be argued that the investing public has not relied upon his expertise. On the other hand, it is arguable that as long as the disclosure document is still affecting the trading market the fraud continues and therefore is \textit{"in the course of the representation."}\footnote{123} It also can be argued that even though the investing public has not relied upon this attorney, his silence effectively condones continued reliance on his predecessor's expertise.

While it is arguable that a lawyer should not be responsible for documents he did not prepare, and so should not have to reveal ongoing frauds initiated before his representation began, there is no doubt that the attorney may not participate in the preparation of a subsequent document perpetuating the material misstatements or omissions.

3. "Perpetrated a Fraud"

Some writers question whether filing materially misleading periodic reports with the SEC should be considered a fraud.\footnote{124} They argue that DR 7-102(B)(1) contemplates fraud in the stringent common law sense only,\footnote{125} while others claim that it includes the more attenuated concept of fraud that prevails in the securities field.\footnote{126}

\footnote{122. See Committee on Counsel Responsibility and Liability, supra note 105, at 1301.}
\footnote{123. See generally Cohen, Wheat \& Henderson, supra note 76, at 233-35.}
\footnote{124. Introduction to Expanding Responsibilities, supra note 27, at x.}
\footnote{125. See Cohen, Wheat \& Henderson, supra note 76, at 224. See generally Lipman, supra note 18, at 461.}
\footnote{126. Introduction to Expanding Responsibilities, supra note 27, at xi-xii. These commentators support their interpretation by referring to the existence of criminal penalties for willful and knowing violation of the securities acts (see note 118 supra and accompanying text). They argue that a client who proceeds to file a disclosure document despite his attorney's warning that it will...}
The latter view is the more sensible. To say that fraud as used in DR 7-102(B)(1) does not include securities violations is tantamount to saying that securities fraud is exempt from the disciplinary rule. Given the tremendous harm a misleading disclosure document can cause, it is inconceivable that the drafters of DR 7-102(B)(1) could have intended such a result.

4. "Upon a Person or Tribunal"

Another question often raised is whether the SEC is a "person" or "tribunal" to whom a fraud must be revealed pursuant to DR 7-102(B)(1). Since the Code of Professional Responsibility defines "person" as "a corporation, an association, a trust, a partnership, and any other organization or legal entity," the SEC is clearly a 'person'; whether or not it is a person 'affected' by a fraud and thus a person to whom a fraud may be disclosed will usually be irrelevant [since] members of the public . . . will clearly be 'affected' by a securities fraud—and disclosure to the SEC will necessarily be made in conjunction with . . . disclosure to the public." The Code defines "tribunal" as "all courts and all other adjudicatory bodies," and "[t]hroughout the [Code] 'tribunal' is used in the context of the adversary system . . . ." When the SEC receives disclosure documents from reporting companies it is not functioning as an adjudicatory body, so in that context the SEC apparently is not a "tribunal." On the other hand, the SEC would be a "tribunal" when conducting a hearing or similar proceeding.

Denying the SEC the status of a "tribunal" would appear to have at least one important consequence. Under DR 7-102(B)(2), a lawyer who receives information clearly establishing that "[a] person other than his client has perpetrated a fraud upon a tribunal shall promptly reveal the fraud to the tribunal." Thus if the SEC were a tribunal, the

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127. ABA Code of Professional Responsibility, Definition No. 3 (1975).
128. Committee on Counsel Responsibility and Liability, supra note 105, at 1298-99; see Daley & Karmel, Attorneys' Responsibilities: Adversaries at the Bar of the SEC, 24 Emory L.J. 747, 756 (1975) ("An affected person, even under Rule 10b-5, may be the purchaser or seller who was a party to the fraud, but not the SEC.").
129. ABA Code of Professional Responsibility, Definition No. 6 (1975).
131. See Lipman, supra note 14, at 458 ("When acting as administrators or enforcers of the laws under their jurisdiction, administrative agencies are not considered tribunals under the Code of Professional Responsibility."). But see Expanding Responsibilities, supra note 27, at x, xli, 9.
132. See Committee on Counsel Responsibility and Liability, supra note 105, at 1299.
attorney faced with a client determined to violate the securities laws could merely resign; but if after resigning the violation ultimately did occur he would be obligated to reveal the clearly established fraud of the "person other than his client" to the SEC as the affected tribunal. Conversely, if the SEC is not a tribunal then the attorney in this situation need not disclose to the SEC.134

5. "Except When the Information is Protected as a Privileged Communication"

The above language was recently added to the ABA draft of DR 7-102(B)(1), presumably to protect confidences that would be protected under state law by the attorney-client privilege.135 However, since ongoing and prospective crimes or frauds are not privileged,136 most securities crimes or frauds will not be protected.137 Thus, the 1974 amendment should not significantly reduce disclosure under DR 7-102(B)(1).

The crime-fraud exception to the attorney-client privilege is broader than DR 7-102(B)(1); that is, there is no privilege for any ongoing or future crimes or frauds, regardless of whether they occur during or after the attorney's representation. As a result, even though an attorney resigning prior to the perpetration of the crime or fraud would not be required under DR 7-102(B)(1) to take the initiative and report his client,138 an attorney subpoenaed to a judicial proceeding would be compelled to testify as to this unprivileged matter. This result is not troublesome, for it seems less egregious to require an attorney to testify once he has been subpoenaed, than to make him take the first step and turn in his client.

135. It appears that this language has not yet been adopted in New York. See N.Y.S.B.A., The Lawyer's Code of Professional Responsibility DR 7-102(B)(1) (1970), as amended (1975); N.Y.S.B.A., Special Comm. to Review the Code of Professional Responsibility, Report on the Provisions Relating to Confidences, Secrets and the Duty of Diligence to the Client 7 (1975) (proposes that when the client refuses to rectify a past fraud or refrain from a prospective fraud the attorney be required to withdraw or request permission to withdraw, rather than reveal the fraud).
136. Leiman, supra note 18, at 269.
137. See pt. III(B) supra.
138. See Gonson, supra note 12, at 16-17. One commentator has stated that he "cannot see that the additional language ... contributes much to the learning on the subject or why it deserves much attention . . . ." Leiman, supra note 18, at 270; cf. id. at 281-85 (remarks of Commissioner Pollack).
139. See text accompanying notes 111-115 supra. But under DR 4-101(C)(3) he would be permitted to reveal his client's intention to commit a crime. See text accompanying notes 119-120 supra.
The crux of the SEC's case against the attorneys [in National Student Marketing\textsuperscript{140}] and the principal cause for concern among securities lawyers . . . lies in the Commission's attempt to make attorneys in their role as counsel [, rather than as primary participants,] subject to securities-fraud liability. While the SEC has alleged that the [attorneys] violated . . ., conspired to violate [] and aided and abetted violations] of the securities laws,\textsuperscript{141} the Commission will probably rely most heavily [on the aiding and abetting allegation]. The lines are unclear between the three kinds of violations—participation, aiding-abetting, and conspiracy\textsuperscript{142}—but the lawyer's role of counseling and assisting fits most comfortably under the aiding and abetting rubric.\textsuperscript{143}

The question of what scienter should be required for a court to impose aiding and abetting liability on a professional "has been a source of controversy in federal securities law . . ."\textsuperscript{144}

In SEC v. Spectrum, Ltd.,\textsuperscript{145} the Second Circuit remanded to the district court for a determination of whether the attorney had been negligent in issuing an opinion letter that was used to sell unregistered stock in violation of the securities laws. In remanding, Chief Judge Kaufman stated that it is not necessary to show actual knowledge of the improper scheme plus an intent to further that scheme [but rather] the negligence standard [is] sufficient in the context of enforcement proceedings seeking equitable or prophylactic relief.\textsuperscript{146}

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\textsuperscript{140} See note 22 supra.


\textsuperscript{143} Note, Securities Regulation—Attorneys' Liability—Advising, Abetting, and the SEC's National Student Marketing Offensive, 50 Texas L. Rev. 1265, 1267 (1972) (emphasis in original) [hereinafter cited as Attorneys' Liability].

\textsuperscript{144} White v. Abrams, 495 F.2d 724, 729 (9th Cir. 1974); see Ruder, supra note 144, at 630-31. See also 2 A. Bromberg, Securities Law: Fraud, SEC Rule 10b-5, § 8.5, at 530-39 (1975); Restatement of Torts § 876(b) (1939).

\textsuperscript{145} 489 F.2d 535 (2d Cir. 1973) (SEC enforcement action for attorney's allegedly negligent issuance of opinion letter used to illegally distribute unregistered stock); see Cheek, supra note 11, at 608-09. For a discussion of Spectrum see Lipman, supra note 14, at 443-47.

\textsuperscript{146} 489 F.2d at 541. Thus far a negligence standard of aiding and abetting has not been
The *Spectrum* decision may have been tempered by a later Second Circuit decision, *SEC v. Management Dynamics, Inc.* There, Chief Judge Kaufman, in discussing the degree of culpability needed to impose liability on aiders and abettors, referred to *Spectrum*, and said:

In *Spectrum* we ruled that the liability of a lawyer as an aider and abettor was to be measured by the negligence standard generally applicable to SEC injunction actions and *the high degree of carelessness present there.*

Chief Judge Kaufman stated that the attorney in *Spectrum* "could easily have concluded that the opinion letter which he issued was likely to be used to sell unregistered securities," in contrast to the attorney in *Management Dynamics* who could not have known that his activity was furthering an illegal scheme.

Although *Spectrum* is not the rule in all circuits, the Seventh Circuit recently adopted a negligence standard for aiding and abetting, and the Ninth Circuit has rejected scienter in favor of a "flexible duty standard," which presumably would apply to both

adopted in a damage action against an attorney, but has been applied in damage actions against accountants, see Hochfelder v. Ernst & Ernst, 503 F.2d 1100, 1104 (7th Cir. 1974), rev'd, 44 U.S.L.W. 4451 (U.S. Mar. 30, 1976), and a stock exchange, see Hochfelder v. Midwest Stock Exch., 503 F.2d 364, 374-75 (7th Cir.), cert. denied, 419 U.S. 875 (1974).

147. 515 F.2d 801 (2d Cir. 1975).
148. Id. at 811 (emphasis added).
149. Id.

151. Hochfelder v. Ernst & Ernst, 503 F.2d 1100 (7th Cir.), rev'd, 44 U.S.L.W. 4451 (U.S. Mar. 30, 1976), (accountants); Hochfelder v. Midwest Stock Exch., 503 F.2d 364 (7th Cir.), cert. denied, 419 U.S. 875 (1974) (stock exchange). On the related question of whether knowledge of fraud coupled with mere inaction constitutes aiding and abetting see SEC v. E.L. Aaron & Co. (S.D.N.Y.), discussed in 175 N.Y.L.J., Feb. 27, 1976, at 1, col. 3 (SEC complaint filed against issuer who knew of but did nothing to correct misrepresentations of its broker); Fischer v. N.Y.S.E., [Current Binder] CCH Fed. Sec. L. Rep. ¶ 95,416 (S.D.N.Y. 1976); Brennan v. Midwestern United Life Ins. Co., 259 F. Supp. 673, 682 (N.D. Ind. 1966), judgment for plaintiff on merits, 286 F. Supp. 702, 704, 729-30 (N.D. Ind. 1968), aff'd, 417 F.2d 147 (7th Cir. 1969), cert. denied, 397 U.S. 989 (1970). Brennan relied on the Restatement of Torts standard "if harm resulting to a third person from the tortious conduct of another," i.e., "a person is liable if he '(b) knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other so to conduct himself, or (c) gives substantial assistance to the other in accomplishing a tortious result and his own conduct, separately considered, constitutes a breach of duty to the third person.' " 259 F. Supp. at 680, quoting Restatement of Torts § 876 (1939).

152. White v. Abrams, 495 F.2d 724, 730-36 (9th Cir. 1974). The Ninth Circuit's use of a "duty analysis" rather than a "scienter analysis" permits a jury to find liability for what would be
aiding and abetting and primary securities violations cases. The Sixth Circuit represents the traditional view that actual knowledge or reckless disregard of the existence of the scheme is necessary to impose aiding and abetting liability.\textsuperscript{153} The Supreme Court heard oral argument on the issue this term.\textsuperscript{154}

2. Suggested Liability for Breach of Duty to Disclose Fraud\textsuperscript{155}

Regardless of the standard that evolves for non-lawyers,\textsuperscript{156} should an attorney preparing disclosure documents be held liable as an aider or abettor when, faced with a client who is about to violate the securities laws, he resigns his employment without disclosing the fraud? Or, under the same facts, should he be liable if he negligently fails to realize that a materially misleading document is being filed and negligently remains in the employment without revealing “the fraud to the affected person or tribunal”?\textsuperscript{157}

It is axiomatic that “[t]he SEC’s concern with respect to the responsibility of attorneys stems principally from the federal securities laws, rather than from ethical obligations imposed by [the Code of Professional Responsibility].”\textsuperscript{158} Indeed, the Code itself makes clear that it does not attempt to define standards for civil liabilities arising out of lawyers’ professional conduct.\textsuperscript{159} However, the standards embodied in

\textsuperscript{153} SEC v. Coffey, 493 F.2d 1304, 1316 (6th Cir. 1974), cert. denied, 420 U.S. 908 (1975); see SEC v. Frank, 388 F.2d 486, 489 (2d Cir. 1968), where the Second Circuit had formerly imposed a knowledge requirement on aiders and abettors.

\textsuperscript{154} The Supreme Court heard oral argument in Hochfelder v. Ernst & Ernst, 503 F.2d 1100 (7th Cir. 1974), cert. granted, 421 U.S. 909 (1975) (negligence standard of accountants’ aiding and abetting). After this Article went to press we learned that the Supreme Court handed down its decision in Hochfelder, 44 U.S. L.W. 4451 (U.S. Mar. 30, 1976), holding that scienter is required for primary liability in 10b-5 private damage actions. The Hochfelder standard of care does not apply to injunctive suits, and so Spectrum is still the law. In any event, Hochfelder supports this author’s view of the standard of care that should be adopted.

\textsuperscript{155} This Article is concerned with the attorney’s duty to disclose, not his independent duty to investigate. The attorney’s duty to disclose concerns the attorney as a drafter of disclosure documents, not as a writer of opinion letters. It should be recalled that SEC v. Spectrum, Ltd., 489 F.2d 535 (2d Cir. 1973) (negligence standard in SEC action for aiding and abetting), involved the attorney as a writer of opinion letters.

\textsuperscript{156} It should be recalled that Hochfelder v. Ernst & Ernst, 503 F.2d 1100 (7th Cir. 1974), cert. granted, 421 U.S. 909 (1975) (accountants), and Hochfelder v. Midwest Stock Exch., 503 F.2d 364 (7th Cir.), cert. denied, 419 U.S. 875 (1974) (stock exchange), did not involve attorneys’ aiding and abetting.

\textsuperscript{157} ABA Code of Professional Responsibility DR 7-102(B)(1) (1975).

\textsuperscript{158} Gonson, supra note 12, at 9.

\textsuperscript{159} ABA Code of Professional Responsibility, Preliminary Statement (1975).
the Code, and in DR 7-102(B)(1) in particular, do reflect the interests of society, and courts and the SEC ought to respect them. Therefore, it is submitted that the Code should be the cornerstone of an analysis of attorney aiding and abetting liability.

Thus, an attorney's failure to disclose a client's fraud should subject him to aider and abettor liability only when he remains in the representation with knowledge of, or in reckless disregard of, his client's violation of the law. Where he resigns before the violation occurs, or remains in the employment while negligently failing to realize that a violation is occurring or will occur, there should be no aider and abettor liability, since under DR 7-102(B)(1) there is no duty to disclose in this situation.

This scienter standard is consistent with DR 7-102(B)(1) which requires that the fraud be clearly established before imposing upon an attorney a duty to reveal the fraud. If a negligence standard were to apply, the securities attorney, to avoid personal liability, would have to disclose, even if the fraud were not "clearly established." This would be contrary to the letter of the Code and would impose a greater duty on securities lawyers than other lawyers.

The determination of the "materiality" of a misstated or omitted fact involves delicate questions of fact and judgment.

[The] kind of case . . . where the wrongdoing of the client is both serious and clear, and where the lawyer participates in the wrongdoing in a substantial way while knowing of the illegality or recklessly disregarding it . . . should be distinguished from

160. Cf. Cheek, supra note 11, at 618. In fact, as suggested earlier (see note 32 supra), the SEC appears to have relied upon the language of DR 7-102(B)(1) of the Code in drafting paragraph 48(i) of the National Student Marketing complaint, either out of respect for the interests advanced by the Code, or out of the necessity to base its complaint upon some pre-existing duty of which the attorneys had notice.

161. Attorneys' Liability, supra note 143, at 1271; see text accompanying notes 88-89 supra.

162. See text accompanying notes 88-89 supra.

163. See pt. IV(C)(1)-(2) supra.

164. See pt. IV(C)(1) supra.

165. See text accompanying notes 88-90 supra for the distinction between objective and subjective standards of "clearly established."

situations where the illegality of the client's act is not clear and a question of judgment is involved.\textsuperscript{167}

Where it is not "clearly established" that a fraud has or will occur the lawyer has a duty to voice his reservations to the client. But if the client decides to file the disclosure document, in hopes that the lawyer's judgment as to the misleading nature or materiality of a particular fact is wrong,\textsuperscript{168} then the lawyer who continues to render legal services to the client in connection with the [document] should not be liable as an " aider and abettor," even if a tribunal ultimately decides that the action of his client was unlawful.\textsuperscript{169}

Imposing a negligence standard of aiding and abetting would also be contrary to the policy of the attorney-client privilege because of the substantial public interest in encouraging clients to seek legal advice—which is reflected in the attorney-client privilege—and in having lawyers able to provide reasonable professional advice without being guarantors of the ultimate correctness of all of their opinions . . . . Any other result would force lawyers either to refuse to perform legal services in every situation where there is any possibility . . . of client liability, or to charge fees commensurate with their guarantor status. Neither result would be in the public interest.\textsuperscript{170}

Thus, regardless of the standard that evolves for other professionals, the policy underlying the attorney-client privilege, \textit{i.e.}, the fostering of effective legal representation, should preclude the imposition of a negligence standard for attorney aiding and abetting for failure to disclose fraud.\textsuperscript{171} An increased threat of civil liability for attorneys failing to disclose their clients' alleged wrongdoing could affect the availability of, or quality of, legal services in the securities field.\textsuperscript{172}

B. \textit{SEC Rule of Practice 2(e)}

SEC Rule of Practice 2(e) provides in part:

\begin{itemize}
  \item (e) Suspension and disbarment.
  \item (1) The Commission may deny, temporarily or permanently, the privilege of
\end{itemize}

\textsuperscript{167}. Cohen, Wheat \& Henderson, supra note 76, at 223; see Committee on Counsel Responsibility and Liability, supra note 105, at 1298, 1301; Lawyers, Clients and Securities Laws, 61 A.B.A.J. 1085 (1975); pt. IV (c)(1) supra.
\textsuperscript{168}. Cohen, Wheat \& Henderson, supra note 76, at 223.
\textsuperscript{169}. Id.
\textsuperscript{170}. Id.; see Cheek, supra note 11, at 632; Leiman, supra note 18, at 272-74; Lipman, supra note 14, at 469-70; Ruder, supra note 142, at 638, 645-46; Schneider, supra note 7, at 9-16; Small, An Attorney's Responsibilities Under Federal and State Securities Laws: Private Counselor or Public Servant?, 61 Calif. L. Rev. 1189 (1973). But see Lowenfels, supra note 2, at 438.
\textsuperscript{172}. See notes 19-21 supra and accompanying text.
appearing or practicing before it in any way to any person who is found by the Commission after notice of and opportunity for hearing in the matter (i) not to possess the requisite qualifications to represent others, or (ii) to be lacking in character or integrity or to have engaged in unethical or improper professional conduct, or (iii) to have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws . . . or the rules and regulations thereunder.\textsuperscript{173}

In a SEC rule 2(e) disciplinary proceeding against an attorney,\textsuperscript{174} is a showing that a lawyer's conduct is consistent with the \textit{Code of Professional Responsibility}, for example DR 7-102(B)(1), sufficient to protect him from any disciplinary action by the Commission? It is submitted that such a showing should suffice, for substantially the same reasons that an attorney should not be held liable as an aider and abettor: liability would be contrary to the letter of DR 7-102(B)(1) which requires that the fraud be "clearly established," and contrary to the policy of the attorney-client privilege to encourage quality legal services.\textsuperscript{175} Furthermore, rule 2(e) seems to compel a \textit{scienter} requirement insofar as it explicitly requires the aiding and abetting to be willful.\textsuperscript{176}

The \textit{Code of Professional Responsibility} remains the primary guideline by which an attorney fashions his professional conduct.\textsuperscript{177} It has been adopted by most state bar groups and incorporated into the rules of practice of most courts "either \textit{in haec verba} or in substantial part."\textsuperscript{178} The SEC (and courts) should defer to the customary practices of the profession and the policies that they reflect.

In a number of cases the SEC seems to have embraced this position by explicitly or implicitly relying on ethical canons to discipline a lawyer.\textsuperscript{179} However, in a recent administrative disbarment proceeding

\begin{footnotes}
\item[173] 17 C.F.R. § 201.2(e) (1975).
\item[175] See pt. V(A) supra.
\item[176] 17 C.F.R. § 201.2(e)(iii) (1975).
\item[177] Professional codes of conduct have been in existence since 1887. See Comment, SEC Disciplinary Rules and the Federal Securities Laws: The Regulation, Role and Responsibilities of the Attorney, 1972 Duke L.J. 969, 976-77.
the Commission specifically stated that it did not feel bound by standards of conduct and ethical duties imposed by state courts upon the profession as a whole, but rather could impose a greater ethical standard upon securities lawyers.\textsuperscript{180}

VI. CONCLUSION

It has been suggested that when a client plans to file a materially misleading disclosure document with the SEC, the attorney may resign prior to the perpetration of the fraud and thereby avoid the disclosure mandated by DR 7-102(B)(1). Concededly, where the client's proposed course of action is especially egregious, the attorney's withdrawal and nondisclosure may fail to prevent undesirable consequences for the investing public. However, this perhaps unfortunate course of conduct is not compelled by DR 7-102(B)(1); while the rule does not compel disclosure when the attorney's resignation occurs prior to his client's fraud, it also does not compel nondisclosure. Under these circumstances, the attorney should look to DR 4-101(C)(3) which, consistent with the crime-fraud exception to the attorney-client privilege, permits the attorney to reveal "[t]he intention of his client to commit a crime and the information necessary to prevent the crime."

Although in the above case disclosure is only permissive, it is hoped that with sensitivity and care an attorney will be able to recognize those situations where, due to the exceptional nature of his client's proposed activity, it is his moral, although not legal, obligation to disclose the relevant facts to the SEC, which is in a position to prevent the crime.

Generally, however, an attorney's duty should go no further. The SEC must temper its enthusiasm "to vindicate public wrongs with a recognition that Draconian or unpredictable standards will demoralize the securities bar and damage the public interest."\textsuperscript{181} The SEC's demand that attorneys become its agents in enforcing compliance with the federal securities laws will erode the trust and confidence upon which the attorney-client relationship is based, and undermine the quality of representation of the securities bar.


\textsuperscript{181.} Lowenfels, supra note 2, at 438; cf. Olmstead v. United States, 277 U.S. 438, 479 (1928) (Brandeis, J., dissenting): "Experience should teach us to be most on our guard to protect liberty when the Government's purposes are beneficent. . . . The greatest dangers to liberty lurk in insidious encroachment by men of zeal, well-meaning but without understanding."